

Lisa R. Thompson

March 2, 1995

AMERICA ONLINE, INC.

		<u>Yr.-End</u>	<u>Revenues</u>	<u>E.P.S.</u>	<u>P/E Ratio</u>
Current Price (AMER):	\$82 1/2	6/96E	\$557.0	\$1.40	58.9
52-Week Range:	\$83 1/4 -23%	6/95E	318.4	0.85	97.1
Shares Outstanding:	23.0MM	6/94*	115.7	0.15	NM
Market Capitalization:	\$1,898MM	6/93*	52.0	0.03	NM

* Restated

We are initiating coverage with a BUY Recommendation.

- America Online, founded in 1985, is the largest and fastest-growing commercial online service company in the U.S., due to its aggressive marketing and award-winning ease-of-use.
- Its recent acquisitions of Redgate, Booklink Technologies, and NaviSoft, although initially dilutive, should expand revenue opportunities for the Company. These early-stage companies will require development dollars and time to reach their potential.
- In the past year, AOL has surpassed both Prodigy and CompuServe domestically in subscriber count.
- AOL has set the groundwork to compete effectively with Microsoft's new Network service, AT&T's forthcoming services, and the Internet access industry.
- AOL is considered an attractive acquisition candidate, although, to date, management has discouraged overtures.
- The Company's aggressive accounting clouds earnings quality, but has allowed the Company to grow revenue and subscriber growth aggressively. It is this growth that is driving the stock.

AMERICA ONLINE, INC.

FINANCIAL PROFILE

			<u>E.P.S.</u>	<u>"Street"</u>	<u>P/E Ratio</u>	<u>Growth Rate</u>
Price (AMER/OTC)	\$82½	6/96E	\$1.40	\$1.33	58.9	64.7%
Price Range (52 weeks)	\$83¼ - 23¾	6/95E	0.85	0.78	97.1	466.6
Fully Diluted Shares Out. (in mil.)	23.0	6/94	0.15	-	NM	400.0
Market Capitalization (in mil.)	\$1,898	6/93	0.03	-	NM	NM
Quarterly Earnings Progression						
			<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
Short Position (in thousands)	4,422					
Short Position (vs. Last Month)	25.2%					
Shares in Float (in thousands)	18,000					
Average Daily Volume (in thousands)	328	6/96E	\$0.30	\$0.33	\$0.37	\$0.39
Short Position/Float	25%	6/95E	0.16A	0.19A	0.24	0.26
Days to Cover Short Position*	13	6/94	0.02	0.00	0.07	0.05

* assumes double counting

Income Statement Highlights

(in mils. except margins)

	<u>6/94</u>	<u>6/95E</u>	<u>6/96E</u>
Revenues	\$115.7	\$318.4	\$557.0
Gross Margin	40.3%	43.1%	42.5%
Operating Income	4.6	28.8	47.8
Operating Margin	4.0%	9.0%	8.6%
Pretax Income	6.4	31.7*	54.0
Pretax Margin	5.5%	10.0%	9.7%
Tax Rate	60.0%	38.1%	38.1%

* before merger expenses

Balance Sheet Highlights

(in mils. except BV/S and ROE)

	<u>6/94</u>	<u>6/95E</u>	<u>6/96E</u>
Cash & Marketable Sec.	\$67.7	\$89.0	\$60.0
Receivables, Net	5.2	0.2	0.2
Short-term Debt	0.3	0.3	0.3
Long-term Debt	5.8	5.6	5.4
Shareholders' Equity	98.9	157.7	191.1
Book Value/Share.. . . .	\$5.36	\$6.75	\$5.76
Return-End Equity	2.3%	17.6%	17.5%

Revenue Analysis

Subscriber Revenue	85.9%	94.8%	97.5%
Redgate Revenues	11.2%	4.2%	2.0%
Development	2.9%	1.0%	0.5%

Cash Flows

Net Income	\$ 2.6R	\$ 18.5*	\$ 33.4
Depreciation	20.4R	54.3	100.0
Operating Sources	\$23.0	\$72.8	\$133.4
Capital Spending	17.5	60.0	110.0

* before merger expenses

Growth Revenues Income E.P.S.

1990-1994	56.6%	40.6%	-10.6%
1994-1996E	119.4%	260.0%	205.5%

Annual Pretax Balance Sheet Trends

Receivables (DSO)	19.0	11.0	8.0
Curr. Liabilities (DSO)	100.0	96.0	96.0

Punk, Ziegel & Knoell is a market maker in America Online, Inc.

AMERICA ONLINE, INC.

America Online, based in Vienna, VA, is the fastest-growing commercial online service in the U.S. It has recently hit the two million subscriber mark, and is the largest online service in the U.S., followed by CompuServe at 1.8 million U.S. subscribers. America Online also licenses its technology to Apple for its new e-World service. The Company recently purchased Redgate Communications, a multimedia marketing firm, in order to expand its offerings and acquire new subscribers even more quickly in the race to build market share. It also purchased Booklink Technologies (for the new Internet browser software), NaviSoft (for tools to put content on the Internet) and ANS (for its TCP/IP network). These acquisitions are initially dilutive. Numbers in this report are restated for the Redgate acquisition, which was a pooling.

America Online's current mission is to capture market share and to be well positioned in the emerging battle as a major Internet access provider. Investors should focus on the growth in subscribers on the network, revenues per subscriber, and the Company's expansion of services and geographies rather than earnings. Although accounting practices are aggressive, we believe that current holders of the stock are looking past actual earnings, and own the stock for its potential, rather than its current status. As a result, we believe the stock, which cannot be valued off earnings, will trade in relation to news events. We would be buyers of the stock on weakness, which periodically arises from publicity of competitive network offerings, the next which should be AT&T.

The Market for Online Services

The U.S.-based online services market is expected to grow 56.3% this year to \$680 million, according to *Electronic Mail & Messaging Systems (EMMS)*. Subscriber count is expected to go up 61.4%, to 4.85 million households. Next year, EMMS believes the market will grow 61.8%, to \$1.1 billion, while households reach 8.9 million users. In U.S. subscribers, we estimate that America Online has 2.0 million versus CompuServe's 1.8 million and Prodigy's 1.4 million. America Online, currently in its seasonally strong period, appears to be adding more than 50,000 net subscribers per week; it is the only one of the big three that is increasing its market share.

Table 1

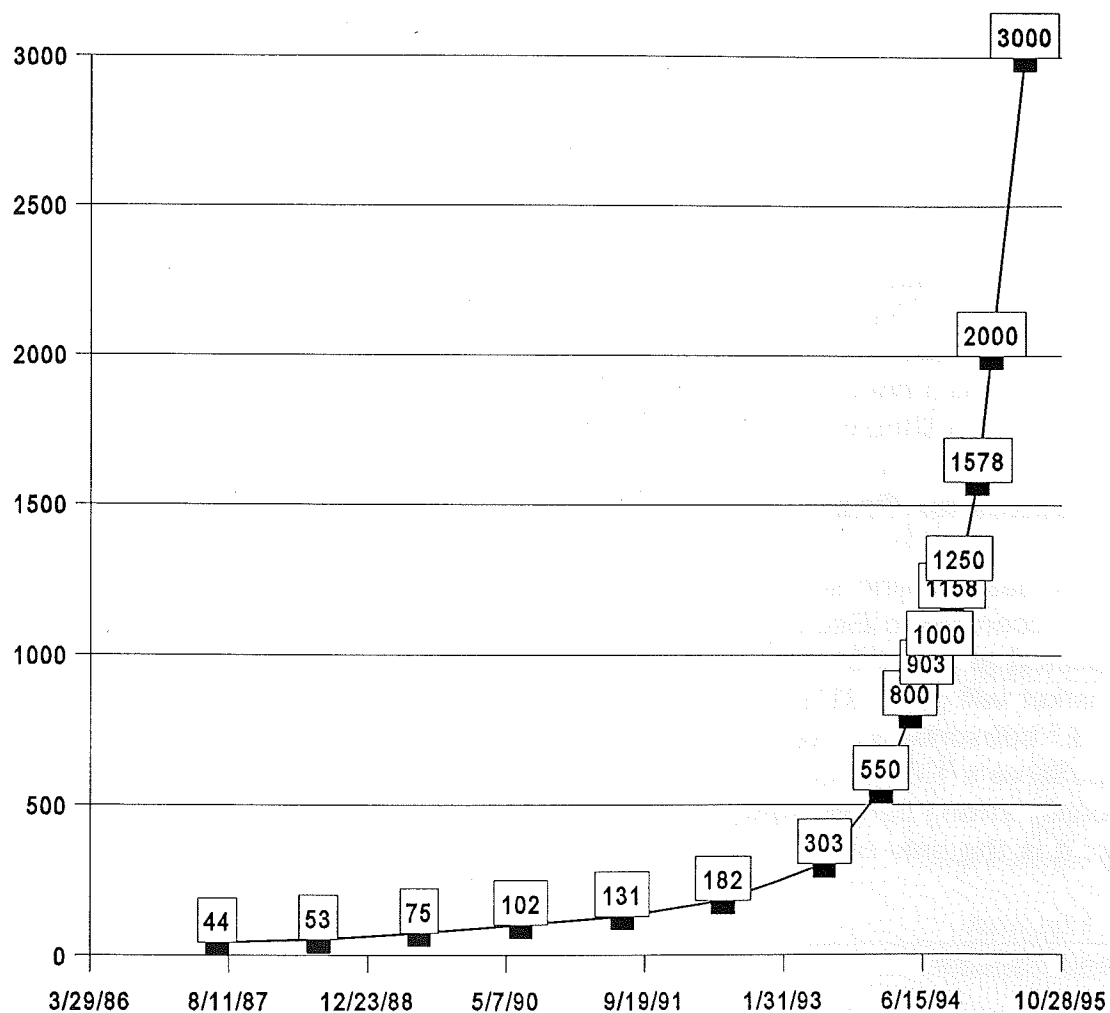
U.S. Online Services Market				
	1993	1994	1995	1996
Revenues	\$435	\$680	\$1,100	\$1,750
Subscribers	3.00	4.85	8.90	14.50
% of Households	3.2%	5.0%	9.1%	14.7%

Source: *Electronic Mail & Messaging Systems*

The online business has struggled for years to reach significant numbers of users, and has only recently had its growth accelerate due to the proliferation of PCs in the home, and more importantly, of modems. Online services are used primarily for communications, followed by information gathering. The post office and the library are just too slow for our "need-it-yesterday" requirements. The economic trends of communications and data storage are in the favor of electronic methods at the expense of paper-based means, and we expect the market to continue to expand.

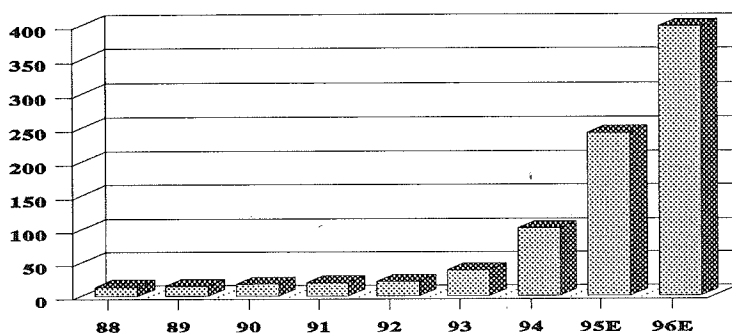
Graph 1

Number of Subscribers



Graph 2

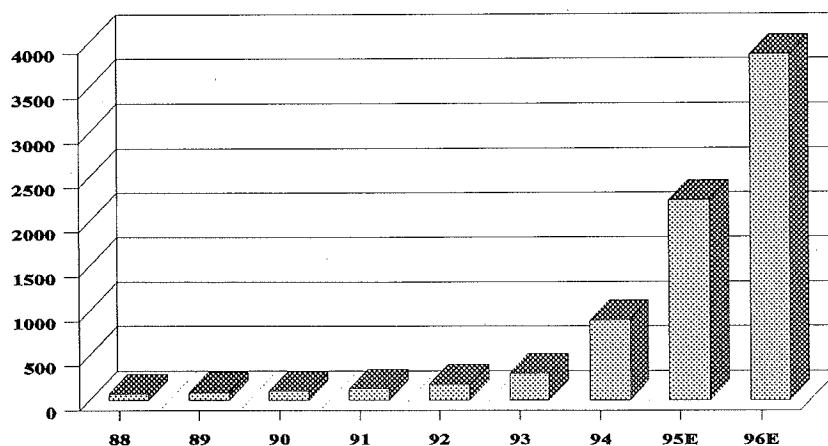
Subscriber Revenues
\$ in millions



Year	Revenues
1988	\$13.4M
1989	15.1
1990	17.3
1991	19.5
1992	21.6
1993	38.5
1994	101.0
1995E	311.0
1996E	540.0

Graph 3

Fiscal Year-End Number of Subscribers
in thousands

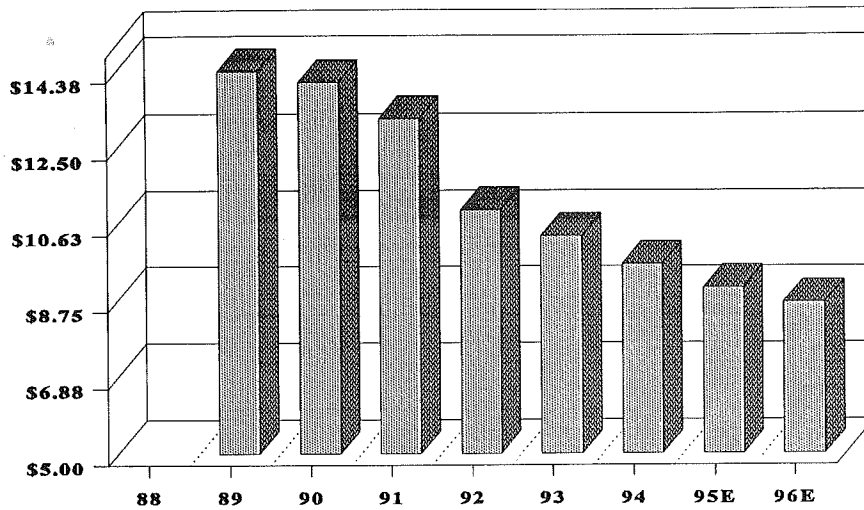


Year	Subscribers
1988	75,000
1989	90,000
1990	101,800
1991	130,600
1992	181,637
1993	302,500
1994	903,000
1995E	2,400,000
1996E	3,875,000

Although the number of AOL subscribers is growing, an increasing percent of those subscribers appear to be on a free trial basis. This explains, while total revenues and the revenues-per-paying subscriber are increasing, the revenues per total subscriber is declining. The Company reports revenue-per-paying subscriber, which is why we have calculated average monthly revenue-per-average subscriber for the year and compared the two. The difference in the numbers can be used to estimate the percent of subscribers on the one-month free trial. We expect this number to decline as the growth rate of adding subscribers slows. Since 80% of those on the free trial convert into paying customers, trials portend future revenues.

Graph 4

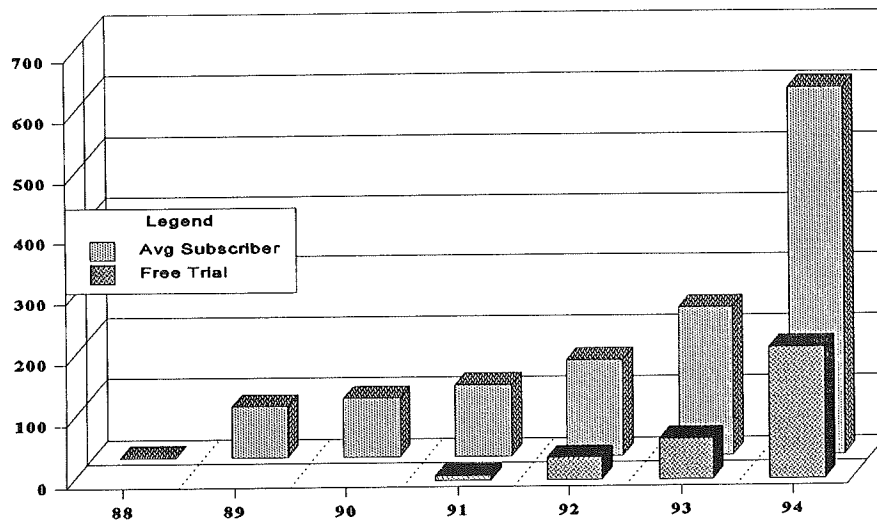
Average Monthly Revenue per Subscriber



Year	Revenue/Subscriber
1989	\$14.36
1990	14.09
1991	13.21
1992	10.97
1993	10.34
1994	9.64
1995E	9.06
1996E	8.70

Graph 5

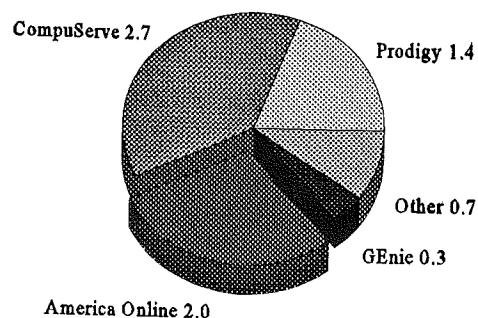
Average Number of Subscribers in thousands



The Competition

Besides the usual competition for consumer dollars and time, America Online competes with the major service suppliers--CompuServe, Prodigy and Genie--as well as smaller access providers to the Internet, such as Delphi, Performance Systems International (PSI), NETCOM and UUNet. Each service has a different profile of users, strengths and pricing structure. America Online's claim to fame is that it is the easiest to use and the cheapest (although Prodigy recently matched their pricing). It also provides the most Internet access of the big three commercial service suppliers. In addition to e-mail and USENET, AOL added Gopher, WAIS, FTP, World Wide Web, Internet Relay Chat and Telnet supports. The Company has set up a separate operation to pursue Internet opportunities.

Graph 6
Online Market Share
Number of Paying Accounts



AOL has been extremely aggressive and clever at marketing its service. Its start-up kits are ubiquitous and the Company should be credited with the growth of the entire market as consumers have been made aware of online services. Having been at this business for more than 15 years, CompuServe and Prodigy had gotten somewhat complacent in the market, which has been growing, but stable. Prodigy, which has been losing money for years, had no incentive to increase losses by further marketing, while the folks in Columbus, Ohio thrived on the "if-its-not-broke-don't-fix-it" school. AOL rapidly grew to number one, and hit two million users in February. By its own admission, H&R Block was given a wake-up call to maintain its market share. And Prodigy, (owned by IBM and Sears) in the new Gerstner era, was probably given a mandate to change. There have been rumors that Prodigy will be bought by IBM entirely, eliminating Sears. Although we have no data on Prodigy's usage, we believe they grew subscribers 25% last year but have been losing market share. CompuServe, on the other hand, added 160,000 users in January, and has been growing subscribers 60% (off a larger base).

In evidence of their newfound competitiveness, Prodigy cut prices in October to \$9.95 per month and \$2.95 each additional hour from \$14.95 per month and \$3.60 per hour. CompuServe implemented a 50% price cut in February. Interestingly, these price cuts have spurred volumes and profitability. Prodigy was the first to offer online banking through Microsoft Money and Chase and is the first to debut a front-end that seamlessly integrates the Internet into its online service. CompuServe was first to supply multimedia companion software for services and shopping.

Another fly in the ointment is the impending entry of Microsoft's Network service. Microsoft plans to build an icon into Windows 95 that will allow users to dial into its Network. We also know Microsoft has signed 50 vendors to provide tech support forums, has made some deals with content suppliers, and has contracted with Sprint, AT&T, British Telecom and Unitel Communications for a worldwide network in 35 countries. It recently bought a position in UUNet through which it will get a national TCP/IP network. Microsoft has said that it intends to use its network for online product support for its products, much like the forums in current services allow (AOL has over 250 companies on theirs). Microsoft has implied that its network will be used for online banking with Intuit. And that is all we know about Microsoft Network. How successful will they be? There are too many unknowns and not enough equations for this analyst.

The other player entering the online market in 1995 is AT&T. Its new service is called *Interchange Online* and it will be introduced this spring, possibly at InterOp. It has already purchased the Imagination Network and Ziff-Net, and plans to spend \$100 million marketing the new network.

Internet Access

On the Internet access competitive front, AOL has been the leader. AOL, CompuServe and Prodigy are not actually connected to the Internet, but have gateways to Internet applications. USENET access is through caching. What this means is that a member is not actually on the Internet, but is looking at AOL's server. AOL's server downloads 12,000 newsgroups every five minutes. As a result, access is slower, and tools such as Mosaic cannot be used. The way to get to the real Internet is to sign up with an Internet provider such as Pipeline (PSI), have a corporate account (\$10,000 per year), or be affiliated with a university. To clarify, if you are not on a network, which is connected to other networks through TCP/IP or cannot exchange documents with them, you ain't on the Internet!

Critics claim that the Internet, being virtually free (depending on your account) is growing much faster than commercial services, and will eliminate their usefulness. For one, the Internet is not free. Internet access providers charge a fee for a connection into the Internet. An individual user can, however, get unlimited usage for around \$35 a month, plus phone charges. Services basically cost about a \$1 per hour. Also, the Internet is difficult to use, not very secure and not entirely reliable, particularly for messaging. The other main reason commercial online services will continue to exist is that there is plenty of information out there that is difficult to find, manage, search and extract. Commercial suppliers have the ability to manage and maintain the data, provide tools, manage billing and provide technical support. Users will always be willing to pay a fee to save time and have reliability, especially in the corporate world.

We believe that shortly, commercial online services will blend seamlessly with Internet access. Users will have one account that can be used to either access the Internet or the content of current online suppliers. The big three will have an advantage as they have vastly more members now, and are set up to handle a higher level of customer support. AOL, realizing the Internet could be a major threat, hedged its bet by buying an Internet access supplier, ANS. As their current network is running on SprintNet, an X.25 network, they needed to get access to a TCP/IP network to be an Internet supplier. Both AOL and CompuServe are Internet access providers as separate businesses from their commercial online service. CompuServe currently sells Internet access to corporate customers and is rolling out a consumer service this summer. One currently uses CompuServe Internet services if they try SPRY's *Internet in a Box*. IBM, which owns Prodigy, is already an Internet access provider.

According to The Maloff Company, the Internet access services market is growing 28% per month, sequentially. It is now at approximately a \$521 million run rate, up from \$118 million the year before. AOL has the marketing expertise to enter this market, but will need to build up the ANS network infrastructure which currently has no dial up access service and only 30 nodes.

Table 2

Pricing of Competitive Commercial Online Services

	<u>America Online</u>	<u>Prodigy</u>	<u>CompuServe</u>	<u>GEnie</u>	<u>e-World</u>
Monthly charge	\$9.95	\$9.95	\$9.95	\$8.95	\$8.95
Included hours	5	5	unlimited basic	4	4
Additional hours	\$2.95	\$2.95	\$4.80 (ext. svc.)	\$3.00	\$2.95

The Network Architecture

America Online's network is based on SprintNet, an X.25 datacom network that handles more than one million sessions a day for AOL. Through Sprint, AOL's members have local access in 600 locations. The network is connected to UNIX server front-end processors which perform session management and routing. The database is maintained on Stratus servers and a cluster of UNIX workstations comprised of HP and Sun products. International customers can access the network with a communications surcharge through Sprint. There is no AOL infrastructure set up internationally yet, although the Company plans to add six points of presence (POPs) in Europe and four POPs in the Pacific Rim this year.

Most AOL access is at 9600 baud, but the Company started to roll out 14.4 baud in November, making the service more competitive. The Company has had difficulty keeping up with demand, as Sprint has not been able to provide enough modems on

the network. Also, the network has been criticized as being slow evenings when numerous users log on. The Company is also testing cable access in Castro Valley and through Comcast in a suburb of Philadelphia.

The Redgate Communications Acquisition

In August of 1994, America Online acquired Redgate Communications for \$38 million of stock (547,630 shares) and assumed \$9.2 million of debt and preferred. The Company took a write-off of \$1.7 million in 1Q'95. Redgate had revenues of \$13 million last year and lost \$3.5 million, thus pro forma historical earnings for 1994 are \$0.15 per share versus the \$0.38 originally reported. Going forward, the Company expects that Redgate will be additive, due, in part, to the fact the Company sold off 16% of 2Market, a development stage operation that contributed most of the losses. The Company is considering 2Market as an extraordinary expense. Redgate will continue to be run out of Vero Beach, Florida, although management and some overhead functions will shift to Vienna, VA.

Redgate is a marketing consulting and multimedia development company. Its main sources of revenue have been divided equally among:

- (1) public relations;
- (2) CD conversion of data; and
- (3) marketing consulting on multimedia projects.

The first is basic **public relations** service performed for companies. This business is profitable and is expected to continue. The second, **the conversion of data to CD**, is undertaken for companies that want to port hard copy data to the CD format, such as product catalogs. Customers for this business include Apple and Sun. This business is also profitable. The remaining one-third of Redgate's revenues is from **CD marketing projects (2Market) and INN**, a broadcast operation. This is the entity that lost money.

The CD business is best known for its high profile project, *En Passant*, which was Apple's attempt to test the waters of CD catalog shopping. It did not fare very well as an experiment, although other firms are continuing similar types of tests. Redgate was the entity that signed up the merchants and aggregated the content for Apple. This division published a second CD, 2Market, that was mailed out at Thanksgiving. This was AOL's first attempt to combine online shopping with graphics on a CD.

INN is a private broadcast operation. For \$20,000 or so, the company will broadcast a meeting or presentation to its network of satellite-equipped users. For example, Alex. Brown uses the system to transmit to employees and investors. None of the Redgate operations is expected to be curtailed and other revenue-generating avenues are being pursued.

What Will Redgate Do for AOL?

Redgate is expected to drive AOL subscriber acquisition rates higher through both marketing and innovative product offerings, such as 2Market, the interactive shopping service. AOL believes that it is over the critical one million subscriber level that allows marketers a targeted audience. Just as magazines get over 75% of their revenues through advertising, AOL can exploit its audience. In fact, the Company sells data on its subscriber list in order to generate revenues like magazines do, although Congress is looking into this practice on the basis of privacy issues.

The Booklink Technologies, Inc. Acquisition

On December 23rd, AOL acquired Booklink Technologies, Inc., a subsidiary of CMG Information Services, for 710,000 shares of AOL stock. Booklink is a start-up operation with no revenues, but has introduced a software product called InternetWorks, which is an Internet browser. AOL bought the exclusive rights to InternetWorks, and is adding twenty employees. The newly launched product has received good reviews, and will compete with other Internet browsers such as Mosaic and Cello. InternetWorks will be the exclusive front end to AOL's internet-only service. Parts of the product will be integrated into AOL's online service front end within the next two versions. There was a substantial write-off for Research and Development due to this acquisition in the March quarter.

The NaviSoft Acquisition

NaviSoft, acquired November 30th, is a development-stage writing tools company for companies to put content on the Internet. This is complementary to Redgate's objectives. The company was purchased for 130,000 shares of stock. The head of NaviSoft, David C. Cole, will now run AOL's Internet Service Company. Mr. Cole is best known for having been President of Ashton-Tate. NaviSoft's yet-to-be introduced products will be publishing and authoring tools which will enable content suppliers to create and maintain World Wide Web site on the Internet. AOL believes there are currently no competitive products on the market as of yet. The Company expects a larger part of this acquisition cost to be written off in the March quarter.

The ANS Acquisition

In order to get a head start on building a TCP/IP network, AOL purchased the assets of ANS for \$35 million, consisting of \$20 million in cash and 258,065 shares of common stock. The deal closed in February and will require a \$10-15 million write-off in the March quarter. ANS is located in Yorktown Heights, NY, employs 125 people and is an Internet access provider to corporate customers. It was owned by a not-for-profit entity created by a \$5 million investment by each of IBM, MCI and Northern Telecom. ANS has about 150 customers and generated \$22 million in revenues and \$2 million in losses in the twelve months ending 9/94. Of that \$22

million, \$12 million was revenues generated by a grant from the National Science Foundation. Revenues from NSF cease April 1st, as the government grant ends. ANS was also the wholesaler of service to Pipeline, which was bought by Performance Systems (PSI) in February. AOL expects there to be a penny or two dilution from this acquisition in the next two quarters. The deal is accounted for as a purchase.

The ANS acquisition gives AOL some employees with Internet experience, some revenues and a start in building a network. The Company will need to build out the network in order to increase POP's and add dial-up access--which ANS currently does not provide. We believe this build out could cost AOL another \$30 million. It plans to have 100 POPs by calendar year-end. The Company may finance the required capital investment through sale leasebacks. ANS currently leases T-3 circuits from MCI, a former parent. These T-3 rates are under a long-term contract. On November 21st, MCI introduced its own Internet service, and there is some concern that customers will switch to MCI from ANS. Additionally, IBM contributed 6611 routers to ANS, which will also need to be upgraded. For calendar '95, AOL expects ANS to contribute \$20-25 million in revenues, up from the \$12 million the Company will generate in revenues in 1994 (subtracting out the \$11 million from NSF).

WebSoft Inc.

AOL recently announced the formation of WebSoft, to be headed by William L. Dunn, formerly of Dow Jones & Co. WebSoft's charter will be to provide services to companies wishing to establish an offering on the Internet. WebSoft will not only help set up home pages on the Web, but may help supplement the Internet presence with direct marketing, infomercials and CD ROM catalogs. AOL expects to get other investors interested in WebSoft some time in the next year.

Bertelsmann A.G. Invests to Start European Operation

AOL has announced an agreement with Bertelsmann, Europe's largest media company, to create a joint venture to bring an online service to Germany, France and the United Kingdom. The 50/50 owned venture will be funded by Bertelsmann to the tune of \$100 million. Bertelsmann will also take a 830,000 share stake in AOL in return for \$50 million in cash. The service is expected to roll-out in the late summer or fall. The first step will be to introduce "AOL Away From Home", available as a surcharge on Sprint in Europe. Since AOL did not contribute cash to the operation, no losses will show on the income statement. Earnings should not be expected for at least three years. The deal should close in April.

FINANCIALS

Restated for the Redgate acquisition, America Online revenues grew 123% in FY 1994 to \$116 million and pretax income 178%. EPS came in at \$0.15 versus \$0.03 the year before.

In the first half of 1995, revenues were up 194%. Of that, online service revenues were up 246% to \$120 million. However, gross margins improved, reversing the trend of last years quarters due to new prices negotiated with Sprint. Before merger charges for the Redgate, Booklink and Navisoft acquisitions, six-month EPS rose to \$0.35 versus \$0.02 restated.

Accounting Practices

The most difficult aspect of investing in America Online is sorting out the accounting practices. What is recognized as revenue, what is capitalized and what is expensed can get tricky. With the help of the Company, we have attempted to sort it out below.

Revenues

Revenues are recognized ratably 30 days from the signing on of a new member, because they get a one-month free trial. The Company bills the customer \$9.95 on the thirtieth day to charge them for the coming month, which includes five free hours; at the same time, they are billed for whatever charges they incurred over the initial ten free hours, if any. Revenues are recognized ratably over the course of the month. Deferred revenues for monthly subscription fees billed in advance arise from the timing of bills. Customers are billed when their month ends, which does not always coincide with the Company's end-of-quarter. Over 85% of customers that try the free trials end up as paying subscribers.

Marketing Expense

Marketing expense is composed of four components:

- (1) *Retention marketing* - any marketing targeted at keeping current customers on the system longer;
- (2) *General marketing* - includes trade shows and non-specific programs;
- (3) *Marketing royalties* - or bounties, which are a percent of revenues that are generated by a customer.

These three types of costs are expensed monthly.

- (4) *Deferred Member Acquisition Costs* - this is the piece of marketing that is capitalized. These are the direct costs involved in the solicitation of new customers. It is divided into two categories, each of which uses a different amortization schedule:
- (a) **Direct Marketing** includes all costs incurred by the Company to acquire new subscribers. The amortization period used is 12 months, and starts the month after the costs are recorded. AOL believes that this is acceptable as the average length of time a subscriber stays with the service is 34 months.
 - (b) **OEM Marketing** includes all expenses affiliated with subscribers acquired by OEM marketing arrangements. The amortization period used is 18 months, as there is the additional time a hardware product goes through distribution and sits on a shelf before it reaches an end-user. OEM marketing is the smaller expense of the two. The acquisition cost per subscriber of OEM bundles is less than \$30 per subscriber.

Table 3

Marketing Costs Without Redgate			
	<u>1994</u>	<u>1993</u>	<u>1992</u>
Total Costs for the year	\$41.7MM	\$12.3MM	\$7.3MM
Amount Expensed	4.8	2.0	1.7
Amount Cap. (new subs.)	36.9	10.3	5.6
% of Total	88.5%	83.7%	76.7%

R&D Expense

Software R&D for new products and features is partially capitalized. In 1994, \$8.3 million was spent on product development (up 135%), of which 62% was capitalized versus \$3.5 million, of which 52% was capitalized in 1993. These numbers are before the restatement with Redgate. The amortization period is five years, up from three years, starting in the 1992 fiscal year. These costs include salaries for R&D and associated support costs.

Subscriber

A subscriber is considered anyone that has signed on as a member, including those under the free trial period. A subscriber is deleted as a member when the customer has formally called to cancel their membership.

Managing the Business

Management's main objective is growing the business by increasing market share. The factors they manage by are subscriber growth, number of paid hours, and customer retention.

Valuing America Online

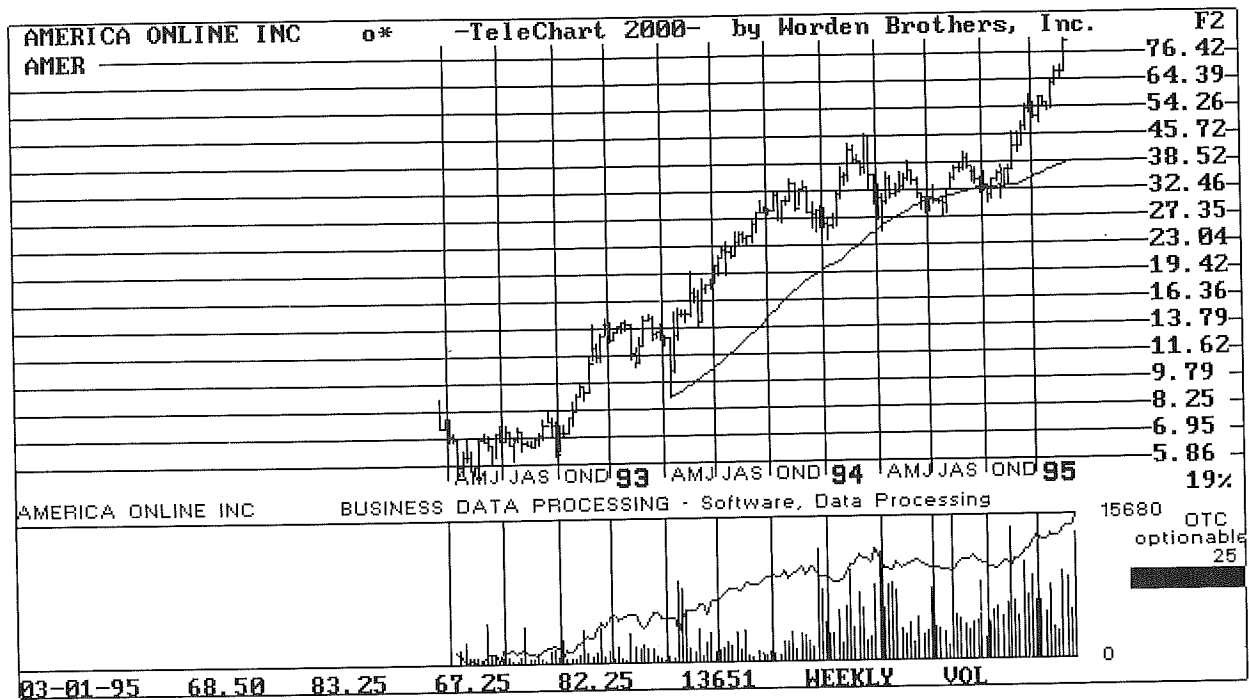
It is difficult to place a valuation on America Online, given its rapid historical growth and position in the marketplace. On a subscriber basis, America Online is valued at \$843 per subscriber. By comparison, the Company generates lifetime revenues of approximately \$612 per subscriber. If this valuation holds, by FY1995, the stock could be \$107 per share.

Forecasts

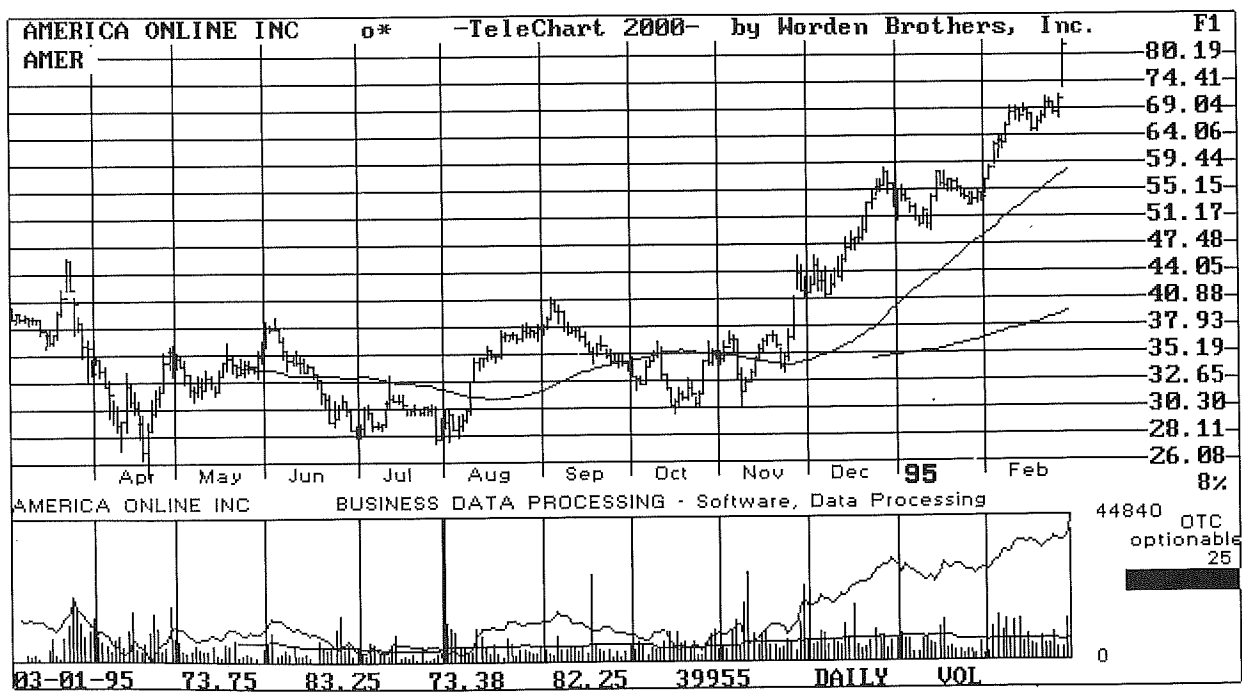
For FY 1995, we are expecting revenues of \$318 million, up from \$116 million in FY 1994, a gain of 43%. Earnings, before one-time charges incurred from acquisition writeoffs, should be \$0.85, versus a restated \$0.15. Fiscal 1996 should get more interesting as Microsoft and AT&T become factors in the marketplace, and the Internet access providers roll out national access. We expect AOL to find subscriber acquisition to be increasingly more difficult, and cash will be consumed both by marketing expenses, built out of the ANS TCP/IP network, and entry into Europe and the Far East. Despite slowing growth, we expect AOL to have an excellent year. With a goal of three million users by mid-June, we believe revenues could hit \$557 million in FY 1996, up 43%. Earnings will depend on how network expansion is handled. We are assuming it will be funded by sale-leasebacks of POPs. With current accounting, EPS could reach \$1.40 versus \$0.85 this year, up 64%.

Stock Price

Since the IPO



Past Twelve Months



Glossary of Terms

FTP (File Transfer Protocol)

is a tool for transferring files between computers on the Internet. You can use FTP to receive files from a remote host computer.

Gopher

Gopher is a tool to enable you to browse Internet resources. Typically you can navigate the Internet using Gopher by selecting the desired item from a series of lists. You can then continue in a series of lists until you locate the information you are seeking. It looks a lot like a table of contents.

Internet

a group of networks that are connected via TCP/IP and can exchange documents.

Mosaic

Mosaic is a software program. It is a browser that makes it easier to find information on the Internet.

TCP/IP (Transmission Control Protocol/Internet Protocol)

A compilation of network and transport level protocols that let a PC speak the same language as other PCs on the Internet.

Newsgroups

a bulletin board-like area on the Internet where users post messages on particular topics. You can subscribe to a newsgroup, and then all messages posted there will be copied and sent to you.

Telnet

Telnet is a tool to allow you to log onto remote computers, access public files and databases, and even run applications on the remote host.

USENET

is a huge, distributed, decentralized, international discussion system. Participants in the USENET exist around the world, reading and writing articles which are posted to a large hierarchical set of newsgroups.

WAIS (Wide Area Information Server)

is a system to search Internet databases. You can do a keyword search using WAIS to retrieve all of the matching documents and then read them.

Statement of Cash Flows

(amounts in thousands)

	Six Months Ended December 31,		
	1994	1993 (unaudited)	% Change
Cash flows from operating activities:			
Net income (loss)	(\$37,715)	\$373	NM
Adjustments to reconcile net income to net			
Cash provided by operating activities:			
Depreciation and amortization	2,647	1,254	111.1%
Provision for bad debts	-	163	NM
Accrued interest	-	31	NM
Amortization of subscriber acquisition costs	21,840	6,284	247.5%
Loss on sale of property and equipment	37	5	640.0%
Charge for accrued R&D	42,785	-	NM
Changes in assets and liabilities:			
Trade accounts receivable	(2,302)	(1,549)	48.6%
Receivables from affiliates	(581)	(1,889)	-69.2%
Other receivables	(2,898)	(325)	791.7%
Prepaid expenses and other current assets	(6,191)	(601)	930.1%
Other assets	(87)	(11)	690.9%
Trade accounts payable	28,657	4,506	536.0%
Accrued personnel costs	1,238	57	2071.9%
Other accrued expenses and liabilities	(7,775)	2,202	-453.1%
Deferred revenue	2,791	306	812.1%
Deferred income taxes	5,908	1,395	323.5%
Deferred rent	7	(45)	-115.6%
Total Adjustments	88,080	11,783	647.5%
Net cash provided by operating activities	88,080	12,156	624.6%
Cash flows from investing activities:			
Short term investments	(2,325)	0	NM
Purchase of property & equipment	(9,071)	(10,661)	-14.9%
Product development costs	(3,304)	(2,023)	63.3%
Sale of property & equipment	180	95	89.5%
Subscriber acquisition costs	(33,048)	(12,117)	172.7%
Proceeds from maturity of certificate of deposit	0	267	NM
Acquisition costs	(1,694)	0	NM
Cash flows from financing activities:			
Proceeds from issuance of common stock, net	2,001	62,895	-96.8%
Proceeds from issuance of preferred stock, net	0	2,048	NM
Proceeds from note payable	0	6,320	NM
Proceeds from issuance of convertible subordinated debt	0	1,000	NM
Principal payments under capital lease obligations	(134)	(95)	41.1%
Net payments on revolving line of credit	(1,690)	(308)	448.7%
Principal and accrued interest payments on notes payable	(175)	(185)	-5.4%
Net cash provided by financing activities	2	71,675	-100.0%
Net increase (decrease) in cash and cash equivalents	(895)	59,392	-101.5%
Cash and cash equivalents at beginning of period	43,891	15,001	192.6%
Cash and cash equivalents at end of period	\$42,996	\$74,393	-42.2%
Supplemental cash flow information			
Cash paid during the period for: Interest	238	300	-20.7%
Income taxes	0	0	0.00%

Balance Sheet
December 31, 1994

America Online, Inc.
8619 Westwood Center Drive
Vienna, VA 22182

All Numbers are with Redgate

ASSETS

Current Assets

	12/31/94	9/30/94	6/30/94	June to Dec. % Change
Cash and equivalents	\$69,373	\$67,207	\$67,943	2.1%
Accounts receivable, net	\$10,849	\$9,492	\$8,547	26.9%
Prepaid expenses & other current assets	17,592	11,203	7,789	125.9%
Deferred subscriber acquisition costs	36,655	29,265	25,459	44.0%
Total Current Assets	\$134,469	\$117,167	\$109,738	22.5%

Fixed Assets

Property & equipment at cost, net	\$27,880	\$22,339	\$20,306	10.0%
Product development costs, net	10,534	9,110	7,912	15.1%
Deferred subscriber acquisition costs	945	958	933	2.7%
Other assets	3,533	2,964	2,853	3.9%
Other intangible assets	7,550	0	0	NM
Deferred income taxes	17,917	14,754	12,842	14.9%
Total Fixed Assets	\$68,359	\$50,125	\$44,846	11.8%

Total Assets	\$202,828	\$167,292	\$154,584	8.2%
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**LIABILITIES
AND
SHAREHOLDERS'
EQUITY**

Current Liabilities

	12/31/94	9/30/94	6/30/94	June to Dec. % Change
Accounts payable trade	\$44,898	\$28,370	\$15,642	81.4%
Accrued liabilities	7,465	9,523	13,972	-31.8%
Deferred revenue	7,279	5,568	4,488	24.1%
Notes payable	253	253	253	0.0%
Revolving line of credit	0	0	1,690	NM
Current portion of LTD & lease	267	267	344	-22.4%
Deferred income tax	13,643	10,977	9,610	14.2%
Total Current Liabilities	73,805	54,958	45,999	19.5%

Notes payable	5,709	5,772	5,836	-1.1%
Capital lease obligations	1,074	1,126	1,179	-4.5%
Deferred income tax	4,273	3,777	3,232	16.9%
Deferred rent	34	38	41	-7.3%
Total Liabilities	84,895	65,671	56,287	16.7%

Shareholders' Equity

Common stock	\$166	\$154	\$154	0.0%
Additional paid-in capital	156,329	101,125	99,067	2.1%
Retained earnings	(38,562)	419	(847)	-149.5%
Total Shareholders' Equity	\$117,933	\$101,698	\$98,374	3.4%

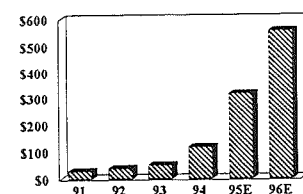
Total Liabilities and Equity	\$202,828	\$167,369	\$154,661	8.2%
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Income Statements (dollars in thousands, except per-share amounts) 3/1/95

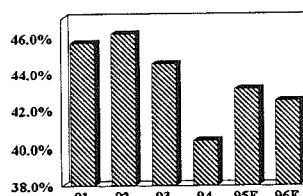
Fiscal Year-End 6/30	Net Sales	Cost of Sales	Gross Margin	Marketing Expenses		R&D Expenses		Gen'l. & A		Operating Income		Other Inc.	One-time Charges	Pretax Income		Income Taxes		Net Income	% of Sales	E.P.S.	EPS Before One-time Charges	Fully Dil. Avg. # Common Shares (thous)
				Amount	% of Sales	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales			Amount	% of Sales	Amount	Eff. Rate					
1996E	557,000	320,500	42.5	115,500	20.7	24,300	4.4	48,900	8.8	47,800	8.6	6,164	0	53,964	9.7	20,560	38.1	33,404	6.0	\$1.40	\$1.40	23,905
Q4E	165,000	94,900	42.5	34,000	20.6	7,000	4.2	15,400	9.3	13,700	8.3	1,595	0	15,295	9.3	5,827	38.1	9,468	5.7	\$0.39	\$0.39	24,230
Q3E	147,000	84,600	42.4	30,500	20.7	6,300	4.3	13,000	8.8	12,600	8.6	1,575	0	14,175	9.6	5,401	38.1	8,774	6.0	\$0.37	\$0.37	24,030
Q2E	130,000	75,000	42.3	27,500	21.2	5,700	4.4	10,500	8.1	11,300	8.7	1,525	0	12,825	9.9	4,886	38.1	7,939	6.1	\$0.33	\$0.33	23,830
Q1E	115,000	66,000	42.6	23,500	20.4	5,300	4.6	10,000	8.7	10,200	8.9	1,469	0	11,669	10.1	4,446	38.1	7,223	6.3	\$0.31	\$0.31	23,530
1995E	318,421	181,123	43.1	67,120	21.1	13,534	4.3	27,888	8.8	28,756	9.0	2,988	66,495	(34,751)	-10.9	13,169	-37.9	(47,920)	-15.0	(\$2.89)	\$0.85	21,042
Q4E	104,000	59,072	43.2	22,000	21.2	4,900	4.7	8,800	8.5	9,228	8.9	750	0	9,978	9.6	3,802	38.1	6,176	5.9	\$0.26	\$0.26	23,380
Q3E	86,000	48,590	43.5	18,232	21.2	3,500	4.1	7,400	8.6	8,278	9.6	800	22,000	(12,922)	-15.0	3,459	-26.8	(16,381)	-19.0	(\$0.73)	\$0.24	22,350
Q2	73,998	41,506	43.9	15,593	21.1	3,377	4.6	6,408	8.7	7,114	9.6	750	42,785	(34,921)	-47.2	4,060	-11.6	(38,981)	-52.7	(\$2.49)	\$0.19	19,900
Q1	54,423	31,955	41.3	11,295	20.8	1,757	3.2	5,280	9.7	4,136	7.6	688	1,710	3,114	5.7	1,848	59.3	1,266	2.3	\$0.07	\$0.16	18,538
1994	115,722	69,043	40.3	23,548	20.3	4,961	4.3	13,562	11.7	4,608	4.0	1,774	0	6,382	5.5	3,832	60.0	2,550	2.2	\$0.15	\$0.15	17,052
Q4	40,423	24,389	39.7	8,553	21.2	1,685	4.2	4,170	10.3	1,626	4.0	594	0	2,220	5.5	1,315	59.2	905	2.2	\$0.05	\$0.05	18,322
Q3	31,689	18,829	40.6	6,326	20.0	1,190	3.8	3,413	10.8	1,931	6.1	463	0	2,394	7.6	1,122	46.9	1,272	4.0	\$0.07	\$0.07	18,370
Q2	24,531	14,660	40.2	4,950	20.2	1,046	4.3	3,355	13.7	520	2.1	313	0	833	3.4	763	91.6	70	0.3	\$0.00	\$0.00	16,142
Q1	19,079	11,165	41.5	3,719	19.5	1,040	5.5	2,624	13.8	531	2.8	404	0	935	4.9	632	67.6	303	1.6	\$0.02	\$0.02	15,418
1993	51,984	28,820	44.6	9,745	18.7	2,913	5.6	8,581	16.5	1,925	3.7	371	0	2,296	4.4	1,897	82.6	399	0.8	\$0.03	\$0.03	14,426
Q4	15,347	8,950	41.7	3,087	20.1	860	5.6	2,534	16.5	(84)	-0.5	55	0	(29)	-0.2	446	NM	(475)	-3.1	(\$0.03)	(\$0.03)	14,032
Q3	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	0	NA	NA	NA	NA	NA	NA	NA	NA	NA
Q2	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	0	NA	NA	NA	NA	NA	NA	NA	NA	NA
Q1	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	0	NA	NA	NA	NA	NA	NA	NA	NA	NA
1992	38,753	20,852	46.2	5,747	14.8	2,015	5.2	6,454	16.7	3,685	9.5	113		3,798	9.8	1,454	38.3	2,344	6.0	\$0.21	\$0.21	11,128
1991	30,161	16,391	45.7	3,623	12.0	2,741	9.1	5,889	19.5	1,517	5.0	(132)		1,385	4.6	576	41.6	809	2.7	\$0.21	\$0.21	3,788

Year-to-Year Percentage Growth

1996E 74.9
Q4E 58.7
Q3E 70.9
Q2E 75.7
Q1E 111.3

Annual Revenues
In Millions

1995E 175.2
Q4E 157.3
Q3E 171.4
Q2 201.7
Q1 185.3

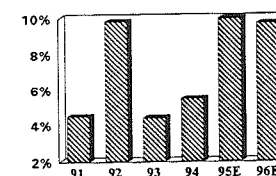
Gross Profit Margin
In %

1994 122.6
Q4 204.3
Q3 178.0
Q2 130.2
Q1 105.4

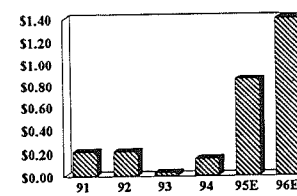
1993 34.1
Q4 NA
Q3 NA
Q2 NA
Q1 NA

1992 28.5
1991 9.4

66.2
48.5
52.2
58.8
146.6
524.0
467.5
328.7
1268.1
678.9

Pretax Margin
In %

-169.7
53.3
-153.6
-120.4
470.5
-1979.2
582.5
-1387.8
-55787.1
317.8

Earnings
Per Share

101.9
194.3
110.5
55.2
47.8
39.4
NA
NA
NA
NA
135.0
NA

63.6
47.9
52.1
75.3
91.9
471.2
434.8
246.6
NM
714.2
66.8
106.9
63.8
33.5
30.7
9.4
NA
NA
NA
NA
98.2
NA

Year-End 6/30	Restated 1993	Q1 94	Q2 94	Pro Forma Q3 94	Restated Q4 94	Q1 95	Q2 95	Q3 95E	Q4 95E	1995E
Revenues	\$51.984	\$19.079	\$24.531	\$31.689	\$40.423	\$54.423	\$73.998	\$86.000	\$104.000	\$318.421
Qtrly Revenues Annualized	\$49.644	\$76.316	\$98.124	\$126.756	\$161.692	\$217.692	\$295.992	\$344.000	\$416.000	\$416.000
Cost Of Goods Sold	\$28.820	\$11.165	\$14.660	\$18.829	\$24.389	\$31.955	\$41.506	\$48.590	\$59.072	\$28.000
Net Income	\$0.399	\$0.303	\$0.070	\$1.824	\$0.905	\$1.266	(\$38.981)	(\$16.381)	\$6.176	\$18.940
Cash & Mkt. Securities	NA	NA	NA	\$76.517	\$67.943	\$67.207	\$69.373	\$82.992	\$89.168	\$89.168
Receivables	NA	NA	NA	\$8.520	\$8.547	\$9.492	\$10.849	\$11.700	\$12.900	\$12.900
Current Liabilities	NA	NA	NA	\$35.650	\$45.999	\$55.958	\$73.805	\$85.776	\$103.729	\$103.729
Short-Term Debt	NA	NA	NA	\$2.194	\$0.253	\$0.253	\$0.253	\$0.253	\$0.253	\$0.253
Long-Term Debt	NA	NA	NA	\$5.899	\$5.836	\$5.772	\$5.709	\$5.645	\$5.581	\$5.581
Stockholders' Equity	NA	NA	NA	\$93.797	\$98.297	\$101.621	\$117.933	\$151.552	\$157.728	\$157.728
Shares Outstanding	14.426	15.418	16.142	18.370	18.322	18.538	19.900	22.350	23.380	21.042
Key Financial Ratios										
Receivables (DSO)	NA	NA	NA	25	19	16	13	12	11	11
Ret. On Equity (%)	NA	NA	NA	7.8	3.7	5.0	-132.2	-43.2	15.7	12.0
Current Ratio	NA	NA	NA	2.9	2.4	2.1	1.7	1.7	1.6	1.6
LTD/Total Permanent Capital	NA	NA	NA	5.9%	5.6%	5.4%	4.6%	3.6%	3.4%	3.4%
Cash Per Share	NA	NA	NA	\$4.17	\$3.71	\$3.63	\$3.49	\$3.71	\$3.81	\$4.24
Book Value	NA	NA	NA	\$5.11	\$5.36	\$5.48	\$5.93	\$6.78	\$6.75	\$6.75

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AMERICA ONLINE, INC.

CORPORATE PROFILE

Headquarters: 8619 Westwood Center Drive
Vienna, VA 22182

Telephone: 703-448-8700
Facsimile: 703-448-0793

I.R. Contact: Richard Hanlon-703-917-1271

America Online is the largest, fastest-growing online service providing consumers access to information and communications in the U.S. It acquired Redgate Communications to enable it to sign up new customers more rapidly and gain market share in this fast growing and competitive market. To pursue Internet opportunities, AOL acquired Booklink, NaviSoft, and ANS, an Internet access supplier. The Company plans to open a service in Europe at the end of 1995.

Officers And Directors

<u>Name</u>	<u>Title</u>	<u>Experience</u>
James V. Kimsey	Chmn	Co-founder
Stephen M. Case	Pres/CEO	Co-founder
Lennert J. Leader	Sr. VP/Fin. & Ad/CFO	LEGENT
Michael M. Connors	Sr. VP/Tech Oper.	IBM
John L. Davies	Sr. VP/Ser.	CitiCorp
Marc S. Seriff	Sr.VP/Res.	Co-founder
Janice Brandt	VP/Mkting	Newfield Publications
Jean N. Villanueva	VP/Corp. Comm.	GEISCo
Audrey Y. Weil	VP/Corp Dev.	Ralston Purina
Theodore J. Leonsis	Pres.	Redgate Communication

Directors

James G. Andress	Pres/CEO	Information Resources
Frank J. Caufield	Partner	Kleiner, Perkins
Alexander M. Haig, Jr.	Chmn/Pres.	Worldwide Assoc.
William N. Melton	Director	Verifone, Inc.
Scott C. Smith	Pres./Publ.	Sun Sentinel Co.

Insider Stock Ownership

Fidelity	1,350,100	5.4
Putnam Investments	1,323,798	5.4
Tribune Company	1,223,856	5.0
Pilgrim Baxter	1,200,000	5.0
Apple Computer	1,000,000	4.1
Sprint Corporation	900,000	3.7
Redgate Shareholders	894,686	3.7
Bertelsmann*	830,000	3.4
West Highland Cap.	722,000	3.0
Stephen M. Case	341,895	1.4
James V. Kinsey	267,308	1.1
William N. Melton	87,000	*
Ted J. Leonis	64,728	*
Alexander Haig	50,332	*
Kleiner Perkins	33,332	*
John L. Davies	27,831	*
James J. Andress	10,666	*
Michael M. Connors	8,348	*
Scott C. Smith	2,666	*
Janice Brandt	280	*
All Officers and Directors	1,612,658	6.9%

* pending deal closure.

Corporate History

1995	<ul style="list-style-type: none">• Acquired ANS.• Bertelsmann invests \$50MM.
1994	<ul style="list-style-type: none">• Acquired Navisoft.• Acquired Booklink.• Acquired Redgate Comm.
1993	Windows version.
1992	<ul style="list-style-type: none">• IPO in March.• Apple agreement.
1985	Company founded as Quantum Computer Services.

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